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C O N F I D E N T I A L SECTION 01 OF 03 TAIPEI 004331

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SUBJECT: TAIWAN DPP LEGISLATORS ON FINANCIAL REFORM

REF: A. TAIPEI 3880

1B. TAIPEI 2984

Classified By: AIT ACTING DIRECTOR DAVID KEEGAN, REASON 1.5 B/D

11. (C) Summary: At an AIT-hosted lunch on October 20, two DPP Legislators criticized the "arbitrary" deadlines and cuts in the number of financial institutions the Chen Administration has called for in Taiwan's second stage of financial reform, but they strongly supported the overall goals of enhancing the competitiveness of Taiwan's financial sector. The Legislators both acknowledged that some allegations of corruption within the ruling DPP may be true, and this made restoring public trust in government officials among the most serious challenges that President Chen and his administration face. The Legislators also discussed cross-strait banking, Taiwan's economic future, the opposition party blocking government privatization plans, and views of the year-end Taiwan election. End summary.

12. (C) AIT/DDIR Keegan hosted a lunch on October 20 for Legislators Chuang suo-hang and Chiang Chao-yi, two DPP members of the Financial Legislative Enhancement Consortium (an LY in-house forum founded and headed by PFP Legislator Christina Liu Yi-ju, ref a) to discuss some of the financial and economic issues now facing Taiwan and the Legislative Yuan (LY). AIT was particularly interested in learning how members of the ruling DPP viewed their membership in an organization led by one of the most vocal critics of the Chen Administration's economic policies.

Second Stage of Financial Reform

13. (C) Both Legislators said they thought some of the criticisms of Taiwan's "second stage financial reforms" were justified and singled-out the arbitrary deadlines and arbitrary goals of reducing by half the number of state-owned banks and financial holding companies (FHCs). "Why reduce the FHCs from 14 to seven?" Dr. Chuang asked, "Why not four? Why not 10?" However, both legislators agreed with the importance of taking measures to improve the overall competitiveness of Taiwan's financial institutions. (The views they expressed closely echoed the views Christina Liu expressed ref a.)

Taiwan's Rich Families

14. (C) However, Dr. Chuang said he did not agree with widely-publicized opposition party criticism that bank consolidation benefited mainly a few wealthy families that support President Chen, and that the process was intended to create opportunities for graft. According to Chuang, participation of Taiwan's wealthiest families is required in the bank consolidation process because only these families possessed the resources to buy shares and the capability to operate and manage the state-owned banks. Chuang said the unfair allegation that these families have been colluding with the Chen Administration reflected the still dominant KMT control over Taiwan media outlets. Chuang noted that the Tsai family, owners of the Fubon Financial Holdings and cited

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in the press as one of the three rich families benefiting from privatization, was, in fact, very close to KMT Taipei City Mayor Ma Ying-jeou. Yet, he continued, no news media have criticized the Taipei City Government for selling the Taipei Bank to Fubon. Chuang also noted that the Koo family (another of the frequently cited three rich families) holds an important position on the KMT Central Standing Committee.

State-owned Enterprises (SOEs)

15. (C) Legislators Chuang and Chiang were both surprisingly open to the possibility that press reports about corruption within the Chen Administration were true. Dr. Chuang attributed government corruption to the system inherited from the days of one-party KMT rule. According to Chuang, President Chen had tried to be politically neutral when he

decided to keep Wang Chung-yu on as the China Steel Corporation (CSC) Chairman after the 2000 election. However, in the next election, Wang openly used CSC funds to campaign for KMT candidates. After leaving CSC, Wang was appointed a KMT legislator at large. Since then, the President has tended to appoint people he knows and trusts to head SOEs. Chuang said that while economic policies can be politically neutral, the appointment of top SOE executives always involved political party considerations. In general, under the Chen Administration SOE performance has improved and more were reporting profits, including Taiwan Salt and China Shipbuilding. Most SOEs lost money under the KMT rule, according to Chuang.

16. (C) Legislator Chiang noted that the government supports allowing major private shareholders to run "privatized" enterprises (those with government ownership below 50%) even though the government still controls more equity than any single private shareholder. An example of this is the Taishin Financial Holding acquisition of Changhwa Commercial Bank, where managerial control over Changhwa was given to Taishin. However, media and opposition party legislators have attacked this kind of arrangement as "corruption." Chiang said that the best way to address the accusations and appearance of SOE-related corruption is through privatization, so the government can avoid involvement in business operations, and conflict between regulator and operator functions. Unfortunately, he said, at present, labor unions and opposition party legislators have united to strongly oppose privatization. The opposition parties managed to pass a non-binding resolution opposing the sale of any government-owned shares, Chiang observed. He added that during the review of the 2006 budget proposal, opposition parties cut to zero the proposed revenue from sales of equity in SOEs. This prevented the government from planned further privatizing of SOEs.

Corruption of Financial Officials

17. (C) Chiang said he believed that Taiwan Stock Exchange (TSE) Chairman Wu Nai-jen and Financial Supervisory Commission (FSC) Chairman Kong Jaw-sheng should step down because of their association with the "vulture" insider trading scandal that erupted in December 2004 (ref b). Chiang said he suspected that these two officials were directly involved in the scandal, as well as Examination Bureau DG Lee Chin-chen. (Taiwan media reported that DG Lee was indicted on October 24.) He noted that recently a mid-level TSE official with close ties to Wu Nai-jen was arrested and charged with leaking information on confidential investigations.

18. (C) Both Chiang and Chuang complained that FSC Chairman Kong has been slow and ineffective in addressing the scandal. According to Chiang, FSC Chairman Kong tried to stymie investigation by the prosecutor's office in favor of an in-house investigation. After the in-house investigation was complete, Kong declared that no wrong-doing had been found. Chiang claimed the FSC investigation was seriously flawed and not convincing. In addition, Chiang criticized FSC Chairman Kong and Vice Chairman Lu Tung-ying for weak leadership. Chiang said that both Kong and Lu fail to manage the FSC commissioners and other staff. He said he believed the Chen Administration should replace these two officials as soon as possible.

Cross-Strait Banking and Internationalization

19. (C) In their sole retreat to the DPP party line, legislators Chiang and Chuang both expressed strong opposition to lifting restrictions on Taiwan banks setting up branches or subsidiaries in China. They contended that doing so would speed-up the process of Taiwan's "hollowing out." However, they do not oppose internationalization, at least in terms of Taiwan banks setting up branches in countries other than China. Legislator Chiang attributed China's rapid economic development to the relocation of much of Taiwan's manufacturing industry to China over the past 15 years. Without the massive investment from Hong Kong and Taiwan, Chiang believes that China's economic development would have been much slower. However, in spite of the investment, Chiang complained, China remains very hostile to Taiwan.

110. (C) According to Chuang, once Taiwan banks set up offices in China, a large number of Taiwan companies will follow in the banks' footsteps. These companies will even relocate their headquarters to China. For the time being, some companies still keep their headquarters in Taiwan simply because they use the banks here for financing. It is still difficult for Taiwan companies in China to obtain loans from Chinese or foreign banks there.

Relationship with PFP Legislator Christina Liu

11. (C) The two DPP legislators explained that they joined the Financial Legislation Enhancement Consortium partly because Liu is one of the top economists in Taiwan and partly because Chuang and Liu studied together at National Taiwan University, and have remained close friends.

Year-End Elections

12. (C) Legislators Chuang and Chiang both expressed concern that the DPP will have a hard time winning county magistrate elections in Changhwa and Pingtung. They speculated that the person most likely to succeed President Chen is Presidential Office Secretary General Yu Shyi-kun.

13. (C) With the exception of toeing the DPP party line on Taiwan banks operating in the PRC, Chuang and Chiang showed an unusual willingness for Taiwan politicians to offer policy assessments without regard for political allegiances.

KEEGAN